This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 AMMAN 009954

SIPDIS

E.O. 12958: N/A
TAGS: EFIN KMPI KTDB ECON JO
SUBJECT: JORDAN'S TAX REFORM: A PROTRACTED TURN IN THE RIGHT DIRECTION

¶1. (SBU) SUMMARY: On November 19, Jordan's government enacted a temporary law - effective January 1 - that makes fundamental changes to the tax code. The changes are based primarily on two years of work by Jordan's Income and Sales Tax Department (ISTD) and its USAID contracted advisor. While not all of the advisor's final recommendations have been implemented in the new law, three basic pillars of the tax reform package remain: simplifying tax rates, broadening the tax base, and lowering tax revenue leakage by eliminating narrowly-defined tax exemptions that favor certain tax payers. Some cabinet ministers favor new exemptions for certain business sectors under the new law. The ISTD has the full support of the new Minister of Finance to stand its ground on the tax reform agenda.

¶2. (SBU) Some Embassy contacts are concerned over the law's legitimacy. Enacted days before the last cabinet left office, the tax amendment was made law in the absence of Parliament under an emergency provision. Subsequently, the Chamber of Deputies rejected the law as unconstitutional, and sent its ruling to the Senate for review. Weak public support for the personal income tax (PIT) part of the amendment is an additional concern. There is some risk of the law being overturned, though few government leaders feel the Senate would do so. The Ministry of Finance and ISTD will develop a communication plan to educate the public and Parliament on the effectiveness of the new tax law. END SUMMARY.

Income & Sales Tax Changes: The Highlights

¶3. (U) According to the Income and Sales Tax Department (ISTD), the PIT changes limit exemptions and make them available to all individuals. Additionally, tax brackets have been lowered from four to two: ten and fifteen percent, depending on income level. For businesses, the tax rate will be fifteen percent in all industries except banking and finance, which will continue to be taxed at thirty-five percent.

¶4. (U) In the sales tax arena, the law broadens the tax base with more companies now required to pay and collect the General Sales Tax (GST). Additional regulatory changes (in progress) will be required to insure the GST exemption for a large number of products is removed, and sales tax administration and compliance is made easier.

Streamlining/Unifying Exemptions

¶5. (U) A key pillar of the Income Tax amendment is the "unification" of exemptions. Exemptions (with no limit on claim amounts) previously used mostly by high-income earners for education, rent, interest on housing loans, and medical treatment have been eliminated. Additionally, exemptions on fifty percent of taxable income for public-sector employees and twenty-five to fifty percent for private-sector employees have also been eliminated. NOTE: Under the old law, self-employed taxpayers (mostly low-income) received no exemptions on their taxable income. END NOTE. In the place of these exemptions, the standard exemption has been raised from 1000 Jordanian Dinars (JD) to 5000 JD for all PIT payers. Exemptions for dependents are capped at 3000 JD. This includes an additional 1000 JD allotted for a spouse and 500 JD per child. As a result, the full standard deduction of up to 8000 JD, applicable to all PIT payers, will be applied evenly and prevent tax revenue leakage from high exemption claimants. The only exemptions outside of standard deductions are income contributions made to the Social Security Corporation, company-sponsored retirement fund, nonrefundable life insurance, and health care insurance premiums.

Tax Rates for Individuals

¶6. (U) Under the amended law, two tax brackets are targeted at two different income levels: lower/middle and high. The first 6000 JD earned by a household, after all exemptions, is taxed at ten percent. Further income is taxed at twenty percent, with a provision to lower it to fifteen percent (falling by one percent each year until 2011), down from the current twenty-five percent. Lowering the tax brackets from four to two simplifies the tax code and, combined with the

higher standard deduction (which excludes most low-income earners from having to pay taxes), shifts the tax burden to those with a higher ability to pay.

Tax Rates for Businesses

¶7. (U) Under the amended law, two tax brackets are delineated: thirty-five percent for banks and financial institutions, and fifteen percent for all other companies. The only change from previous policy is for companies involved in providing services whose tax burden falls from twenty-five to fifteen percent by 2015 (dropping one percent each year). According to the USAID contracted advisor, the push to bring the tax rate for service-based businesses in line with industrial-based businesses is "a small step forward," but the ten-year timeline to do so "is disappointing." The exceptionally high tax rate for banking/financial companies contradicts the USAID advisor,s recommendation that all companies be treated equally, regardless of which business sector they are in. While bringing parity to the tax rate for the banking and finance sector was considered, the previous Minister of Finance noted that there was "too much opposition by National Agenda Committee members."

Changes in General Services Tax (GST) Not Yet Finalized
--- ----------

¶8. (U) On the sales tax side, changes in the law are less pronounced, though promised changes in regulation should have an impact when approved. The USAID advisor recommended moving all products to the sixteen percent single general sales tax (GST) rate and broadening the tax base, i.e., lowering the sales threshold for business entities required to pay and collect GST from customers. The tax amendment broadens the tax base by requiring retail, wholesale, and manufacturing businesses that conduct sales amount volume of 50,000 JD or more to pay and collect GST. The previous threshold for these companies was between 60,000 and 100,000 JD depending on business sector. The law leaves special manufacturing and service-oriented businesses that conduct less than 10,000 and 30,000 JD in sales volume, respectively, exempt from GST.

¶9. (U) When asked why the government did not consolidate the five categories of goods that have a zero-rate GST, the twenty-seven categories that are exempt from tax, and the ninety-two groupings that receive a preferential four percent reduced rate, under the single, actual sixteen percent GST, ISTD Director Qudah replied that these changes "are regulatory and do not require changes in the law." Changes to move these products to the sixteen percent GST rate were drafted with the new law, but could not be submitted in time for the previous cabinet to approve. Qudah conveyed his plans to have the new cabinet approve the regulatory changes when the budget is discussed in early 2006. COMMENT: Until that change is made, tax administration and compliance in this area will remain a challenge to administer. END COMMENT.

¶10. (U) NOTE: While Jordan,s Parliament has previously legislated the GST tax rate of 16 percent, it does not legislate which products receive a preferential tax rate. Removing the tax subsidies that so many products receive is a regulatory decision for the cabinet to make, not a legislative one for Parliament. END NOTE.

Treading Cautiously

¶11. (SBU) Concern in the press over the change in the tax law is growing. Criticisms of the revisions include accusations that the end result will be a heavier tax burden on the poor, and that bypassing Parliament means the government has instituted "taxation without representation." NOTE: Even though the Chamber of Deputies has voted to repeal the temporary law, and some members contest its constitutionality, it remains in effect unless the Senate joins the lower house in voting it down. If the Senate votes in support of the temporary law, the issue returns to the Chamber of Deputies for action. At that point, if the lower house again votes down the law, the two houses combine to vote and a simple majority of the joint session decides the issue. In the interim, the temporary law stands. END NOTE.

¶12. (SBU) In a December 15 meeting new Finance Minister Ziad Fariz held with his team, a communication plan was proposed to educate Parliament and the public on the positive impact of the new tax law. When Fariz requested ISTD Director Iyad Al-Qudah's feedback on this plan in the meeting, Qudah expressed concern over a lack of a budget for communications, e.g., newspaper ads, TV campaign, etc., and over the possibility the Senate would overturn the amended tax law. While Fariz shared Qudah's concern about the law,s standing, he expressed confidence that the Senate would not reject the

law, and asked the group move forward on a communications plan.

¶13. (SBU) In a follow-up December 18 meeting with Qudah, EconOff asked Qudah about any other variables that might derail the new tax law. Qudah expressed concern about Minister of Industry and Trade Sharif Zubi's submission of a draft investment law that would allow tax exemptions for certain business sectors such as industrial zones and the garment sector under the new tax law. Asked if he planned to take any action, Qudah was quick to clarify that his responsibilities at the ISTD were limited to income and sales tax law design, and that he did not have control over laws that other ministers submitted. Subsequently, Finance Minister Fariz said he opposed the draft investment law that gave some private-sector companies favorable tax relief, and requested that Qudah and ISTD draft his arguments against it.

¶14. (SBU) To date, neither the ISTD nor Ministry of Finance leadership has yet to respond to near unanimous opposition in newspaper op-ed pieces that call for the rejection of the tax law changes. COMMENT: ISTD Director Qudah's actions demonstrate both his appreciation for his chain of command, and his cautious approach in taking political risk to defend tax reform. The Finance Minister's strong support for the tax law amendment is important for moving ahead the tax reform agenda, but without a public endorsement of the amendment, he increases the risk of the Senate not passing the changes.

¶15. (SBU) COMMENT CONT.'D: While changes in PIT and GST demonstrate a commitment to reform, more follow-through is needed. Qudah, having made what he considers major changes to the tax code and sales tax regulation, prefers no further changes in the short-term. His current challenge now is to educate the public on the income tax changes and help shepherd the promised regulatory changes in sales tax through Parliament.
Hale